

**REPORT OF THE AUDITOR-GENERAL TO THE KWAZULU-NATAL PROVINCIAL  
LEGISLATURE AND THE COUNCIL ON THE FINANCIAL STATEMENTS AND  
PERFORMANCE INFORMATION OF INDAKA MUNICIPALITY FOR THE YEAR  
ENDED 30 JUNE 2009**

**REPORT ON THE FINANCIAL STATEMENTS**

**Introduction**

1. I was engaged to audit the accompanying financial statements of the Indaka Municipality which comprise the balance sheet as at 30 June 2009, and the income statement, the cash flow statement for the year then ended, and a summary of significant accounting policies and other explanatory notes, as set out on pages [xx] to [xx].

**The accounting officer's responsibility for the financial statements**

2. The accounting officer is responsible for the preparation and presentation of these financial statements in accordance with the entity-specific basis of accounting, as set out in accounting policy note 1 and in the manner required by the Local Government: Municipal Finance Management Act, 2003 (Act No. 56 of 2003) (MFMA) and for such internal control as the accounting officer determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

**The Auditor-General's responsibility**

3. As required by section 188 of the Constitution of the Republic of South Africa, 1996 read with section 4 of the Public Audit Act, 2004 (Act No. 25 of 2004) (PAA) and section 126(3) of the MFMA, my responsibility is to express an opinion on the financial statements based on conducting the audit in accordance with the International Standards on Auditing and *General Notice 616 of 2008*, issued in *Government Gazette No. 31057 of 15 May 2008*. Because of the matters described in the Basis for disclaimer of opinion paragraphs, however, I was not able to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion.

**Basis for disclaimer of opinion**

**Operating expenditure**

4. The completeness, occurrence and accuracy of general expenses totalling R5,7 million in the analysis of operating income and expenses could not be confirmed due to limitations placed on the scope of audit work. In this regard, supporting documentation and related explanations were not provided by the municipality due to the absence of key financial personnel throughout the audit.
5. Payments amounting to R278 125 were not made in accordance with the lease agreements. In this regard, supporting documentation and related explanations were not provided for the unexplained overpayment by the municipality. Consequently, I could not obtain sufficient appropriate audit evidence as to the completeness, occurrence and accuracy of this expenditure due to limitations placed on the scope of audit work.

### **Provisions**

6. The valuation, existence, completeness and obligations of the leave pay provision totalling R660,228 as disclosed in note 8 to the financial statements could not be confirmed due to the limitations placed on the scope of the audit work. Furthermore, alternative procedures were not feasible because leave registers were not up to date and records supporting the balances could not be provided.

### **Unauthorised expenditure**

7. The municipality has omitted disclosure of unauthorised expenditure amounting to R360 874 incurred during the financial year on the purchase of capital assets. This is contrary to section 125(d)(i) of the MFMA which requires disclosure of unauthorised expenditure in the financial statements.

### **Value-added Taxation (VAT) payables**

8. VAT amounting to R100 068,89 in respect of repairs and maintenance and general expenditure was incorrectly recorded in expenditure accounts. Consequently, the projected overstatement of general expenses and repairs and maintenance amounts to R579 949 and R26 005 respectively whilst VAT payable is understated by the same amounts.

### **Fixed assets**

The municipality did not implement appropriate asset management policies and procedures and as a result, the following misstatements were noted during the audit:

9. Assets financed from grants amounting to R11,09 million as per the analysis of fixed assets, did not agree to the asset register which reflected R10,66 million. As a result of insufficient supporting documentation and explanations; the accuracy, completeness and occurrence of the additions to fixed assets amounting to R337 394 financed from grants could not be confirmed.
10. Contributions to fixed assets from operating income of R193 429 as per the analysis of operating income and expenditure did not agree to the analysis of fixed assets. Consequently fixed assets are overstated by R193 429 and accumulated deficit is understated by the same amount.
11. External loans redeemed or written off during the period amounting to R562 443 was not included in the analysis of fixed assets and the analysis of operating income and expenditure. Consequently fixed assets are overstated by R562 443 and accumulated deficit understated by the same amount.
12. Umgejakazi access road which was completed during the period under review per the projects progress report was not capitalised. As a result fixed assets are understated by R648 945.00 and accumulated deficit overstated by the same amount.

Due to the matters described in paragraph 9 to paragraph 12 above, fixed assets are materially misstated and inappropriately disclosed in the financial statements.

13. Fixed assets to the value of R99 055.87 could not be physically located. The fixed asset register is projected to include assets amounting to R326 226 that do not physically exist. The municipality's records did not permit the application of alternative audit procedures. Consequently, I was unable to obtain sufficient appropriate audit evidence to confirm the existence of the assets.

14. With reference to accounting policy 3.1, the municipality's accounting policy is to recognise fixed assets at historic cost or at valuation (based on the market price at date of acquisition), where assets have been acquired by grant or donation while they are in existence and fit for use. However, all fixed assets acquired before 01 July 2007 were stated at revalued amounts. This is the result of a decision taken by management at the start of the preceding financial year and that caused me to qualify my audit opinion on the financial statements relating to that year. Consequently, fixed assets and loans redeemed and other capital receipts were understated by an amount of not less than R691 020.

#### **Accruals**

15. Expenditure amounting to R650 000 incurred on the preparation and staging of the memorial and funeral service of the mayor was unaccounted for. As a result accruals and expenditure are understated by R650 000. Moreover, insufficient explanations and documentation were provided in support of the expenses. Consequently I was unable to satisfy myself that the expense was incurred in accordance with the scope of the municipal operations.
16. The short term portion of the DBSA loans were incorrectly classified as long term liabilities. Instalments amounting to R225 000 should have been made for the current year. Consequently long term liabilities are overstated and current liabilities are understated by R225 000.

#### **Accumulated Deficit**

17. A difference of R320 798 (2007/08 - R188 112) was noted for accumulated deficit. The accumulated deficit as disclosed in the income statement amounted to R5,06 million (2007/08 – R 8,54 million) when compared to the balance sheet and note 13 amount of R5,38 million.(2007/08 – R8,36million). No explanations and documentation in support thereof could be produced on request.
18. There were no disclosure notes and no explanations provided for an amount of R381 680 included in appropriations for the period.
19. Operating surplus for the period as per the income statement amounted to R3,1 million as compared to R2,9 million operating surplus disclosed in note 13. There were no explanations provided for the resultant difference. The municipality's records did not permit the application of alternative audit procedures.

Due to the matters described in paragraph 17 to paragraph 19 above, I was unable to confirm the valuation, existence, and completeness of accumulated deficit as disclosed in the balance sheet and note 13 to the financial statements due to limitations placed on the scope of audit work.

#### **Reserves**

20. The contributions to reserves and operational expenditure thereon during the period as recorded in the general ledger did not agree to disclosures per Appendix A of the financial statement. Consequently contributions to reserves and operational expenditure thereon are understated by R5,99 million due to classification errors.
21. A difference of R230 778 was noted for reserves as disclosed in Appendix A of the financial statements when compared to the closing balances as per the trial balance. No explanations and/or documentation in support of this difference could be produced on request.

**Cash**

22. The balance sheet reflects a negative bank overdraft of R2,8 million under current liabilities. The municipality had a favorable bank balance at year end and this should be reflected as a current asset. Consequently current assets and current liabilities are understated by R2,8 million.

**Capital commitments**

23. The municipality did not have a system in place to account for commitments. Consequently, I was unable to confirm the completeness of commitments as disclosed in note 21 to the financial statements. Moreover, the entity's records did not permit the application of alternative audit procedures.

**Salaries, wages and allowances**

24. Note 10 of the financial statements do not disclose the breakdown of councillor's allowances and senior official remuneration for the current year. As a result the disclosure is not in accordance with accounting policy note 1 and furthermore, is not comparable to the prior year.

**Disclaimer of opinion**

25. Because of the significance of the matters described in the Basis for disclaimer of opinion paragraphs, I have not been able to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion. Accordingly, I do not express an opinion on these financial statements.

**Emphasis of matters**

I draw attention to the following matters on which I do not express a disclaimer of opinion:

**Basis of accounting**

26. The municipality's policy is to prepare financial statements on the entity-specific basis of accounting, as set out in accounting policy note 1.

**Going concern**

27. Note 13 to the financial statements indicates that the Indaka municipality has an accumulated deficit of R5,4 million during the year ended 30 June 2009. Conditional grants amounting to R1,2 million had been utilised for operational expenditure. These conditions, along with other matters as set forth in note 24, indicate the existence of a material uncertainty that may cast significant doubt on the entity's ability to continue as a going concern.

**Other matters**

I draw attention to the following matters that relate to my responsibilities in the audit of the financial statements:

**Material inconsistencies in other information included in the financial statements**

28. Amounts and disclosures included in paragraph 3.1, 5 and 9 of the treasurers report relating to Grants and subsidies, capital expenditure, and going concern relates to the information disclosed in the prior year and not the current year information. As a result, these disclosures are inconsistent with the current year financial statements.

29. Paragraph 8 of the treasurers report incorrectly indicates that the provisions for the prior year amounted to R2,4 million. This is inconsistent with provisions of R660 327 disclosed in note 8 to the financial statements.

#### **Material inconsistencies in information included in the annual report**

30. I have not obtained the other information included in the annual report and have not been able to identify any material inconsistencies with the financial statements.

#### **Unaudited supplementary schedules**

31. The supplementary information set out on **pages xx to xx** does not form part of the financial statements and is presented as additional information. I have not audited these schedules and accordingly I do not express an opinion thereon.

#### **Non-compliance with applicable legislation**

##### **Municipal Finance Management Act**

32. Sections 74(1) and 104(1)(b) of the MFMA were not complied with, in that reports for all contracts awarded over R100,000 had not been submitted to treasury.

33. Unauthorised expenditure amounting to R4,6 million as disclosed in the 2007/08 financial statements was not reported to the MEC for Local Government, as required by section 32(4) of the MFMA.

34. The accounting officer did not make public the prior year annual report and invite the local community to make representations as required by section 127(5) of the MFMA.

#### **Governance framework**

35. The governance principles that impact the auditor's opinion on the financial statements are related to the responsibilities and practices exercised by the accounting officer and executive management and are reflected in the internal control deficiencies and key governance responsibilities addressed below:

#### **Internal control deficiencies**

36. Section 62(1)(c)(i) of the MFMA states that the accounting officer must ensure that the municipality has and maintains effective, efficient and transparent systems of financial and risk management and internal control. The table below depicts the root causes that gave rise to the deficiencies in the system of internal control, which led to the disclaimer of opinion. The root causes are categorised according to the five components of an effective system of internal control. (The number listed per component can be followed with the legend below the table.) In some instances deficiencies exist in more than one internal control component.

Par. no.	Basis for disclaimer of opinion	CE	RA	CA	IC	M
4-5	Operating expenditure	5,6	1			
6	Provisions	6		4		
7	Unauthorised expenditure					2
8	Value added tax			5		
9-14	Fixed assets	5	1			3
15-16	Accruals	5	5			

17-19	Accumulated deficit	5	3			3
20-21	Reserves	5				3
22	Cash	5	1			
23	Capital commitments	5				2
24	Salaries, wages and allowances	5				2

37. The municipality did not submit requested information and documentation in support of its financial affairs for the year under review. Governance policies and practices do not operate effectively and are in some instances inappropriate. Moreover, there was a lack of effective, efficient and transparent systems of financial and risk management and internal control during the period under review.

<b>Legend</b>	
<b>CE = Control environment</b>	
The organisational structure does not address areas of responsibility and lines of reporting to support effective control over financial reporting.	1
Management and staff are not assigned appropriate levels of authority and responsibility to facilitate control over financial reporting.	2
Human resource policies do not facilitate effective recruitment and training, disciplining and supervision of personnel.	3
Integrity and ethical values have not been developed and are not understood to set the standard for financial reporting.	4
The accounting officer/accounting authority does not exercise oversight responsibility over financial reporting and internal control.	5
Management's philosophy and operating style do not promote effective control over financial reporting.	6
The entity does not have individuals competent in financial reporting and related matters.	7
<b>RA = Risk assessment</b>	
Management has not specified financial reporting objectives to enable the identification of risks to reliable financial reporting.	1
The entity does not identify risks to the achievement of financial reporting objectives.	2
The entity does not analyse the likelihood and impact of the risks identified.	3
The entity does not determine a risk strategy/action plan to manage identified risks.	4
The potential for material misstatement due to fraud is not considered.	5
<b>CA = Control activities</b>	
There is inadequate segregation of duties to prevent fraudulent data and asset misappropriation.	1
General information technology controls have not been designed to maintain the integrity of the information system and the security of the data.	2
Manual or automated controls are not designed to ensure that the transactions have occurred, are authorised, and are completely and accurately processed.	3
Actions are not taken to address risks to the achievement of financial reporting objectives.	4
Control activities are not selected and developed to mitigate risks over financial reporting.	5
Policies and procedures related to financial reporting are not established and communicated.	6
Realistic targets are not set for financial performance measures, which are in turn not linked to an effective reward system.	7
<b>IC = Information and communication</b>	
Pertinent information is not identified and captured in a form and time frame to support financial reporting.	1
Information required to implement internal control is not available to personnel to enable internal control responsibilities.	2
Communications do not enable and support the understanding and execution of internal control processes and responsibilities by personnel.	3
<b>M = Monitoring</b>	
Ongoing monitoring and supervision are not undertaken to enable an assessment of the effectiveness of internal control over financial reporting.	1
Neither reviews by internal audit or the audit committee nor self -assessments are evident.	2
Internal control deficiencies are not identified and communicated in a timely manner to allow for corrective action to be taken.	3

### Key governance responsibilities

38. The MFMA tasks the accounting officer with a number of responsibilities concerning financial and risk management and internal control. Fundamental to achieving this is

the implementation of key governance responsibilities, which I have assessed as follows:

No.	Matter	Y	N
<b>Clear trail of supporting documentation that is easily available and provided in a timely manner</b>			
1.	No significant difficulties were experienced during the audit concerning delays or the availability of requested information.		<input type="checkbox"/>
<b>Quality of financial statements and related management information</b>			
2.	The financial statements were not subject to any material amendments resulting from the audit.		<input type="checkbox"/>
3.	The annual report was submitted for consideration prior to the tabling of the auditor's report.		<input type="checkbox"/>
<b>Timeliness of financial statements and management information</b>			
4.	The annual financial statements were submitted for auditing as per the legislated deadlines section 126 of the MFMA.		<input type="checkbox"/>
<b>Availability of key officials during audit</b>			
5.	Key officials were available throughout the audit process.		<input type="checkbox"/>
<b>Development and compliance with risk management, effective internal control and governance practices</b>			
6.	Audit committee	<input type="checkbox"/>	
	<ul style="list-style-type: none"> <li>The municipality had an audit committee in operation throughout the financial year.</li> </ul>	<input type="checkbox"/>	
	<ul style="list-style-type: none"> <li>The audit committee operates in accordance with approved, written terms of reference.</li> </ul>	<input type="checkbox"/>	
	<ul style="list-style-type: none"> <li>The audit committee substantially fulfilled its responsibilities for the year, as set out in section 166(2) of the MFMA.</li> </ul>		<input type="checkbox"/>
7.	Internal audit		
	<ul style="list-style-type: none"> <li>The municipality had an internal audit function in operation throughout the financial year.</li> </ul>	<input type="checkbox"/>	
	<ul style="list-style-type: none"> <li>The internal audit function operates in terms of an approved internal audit plan.</li> </ul>	<input type="checkbox"/>	
	<ul style="list-style-type: none"> <li>The internal audit function substantially fulfilled its responsibilities for the year, as set out in section 165(2) of the MFMA.</li> </ul>		<input type="checkbox"/>
8.	There are no significant deficiencies in the design and implementation of internal control in respect of financial and risk management.		<input type="checkbox"/>
9.	There are no significant deficiencies in the design and implementation of internal control in respect of compliance with applicable laws and regulations.		<input type="checkbox"/>
10.	The information systems were appropriate to facilitate the preparation of the financial statements.		<input type="checkbox"/>
11.	A risk assessment was conducted on a regular basis and a risk management strategy, which includes a fraud prevention plan, is documented and used as set out in section 62(1)(c)(i) of the MFMA.	<input type="checkbox"/>	
12.	Delegations of responsibility are in place, as set out in section 79 of the MFMA.	<input type="checkbox"/>	
<b>Follow-up of audit findings</b>			

No.	Matter	Y	N
13.	The prior year audit findings have been substantially addressed.		<input type="checkbox"/>
14.	SCOPA/Oversight resolutions have been substantially implemented.	<input type="checkbox"/>	
<b>Issues relating to the reporting of performance information</b>			
15.	The information systems were appropriate to facilitate the preparation of a performance report that is accurate and complete.		<input type="checkbox"/>
16.	Adequate control processes and procedures are designed and implemented to ensure the accuracy and completeness of reported performance information.		<input type="checkbox"/>
17.	A strategic plan was prepared and approved for the financial year under review for purposes of monitoring the performance in relation to the budget and delivery by the Indaka municipality against its mandate, predetermined objectives, outputs, indicators and targets section 68 of the MFMA.	<input type="checkbox"/>	
18.	There is a functioning performance management system and performance bonuses are only paid after proper assessment and approval by those charged with governance.	<input type="checkbox"/>	

39. The financial statements submitted for audit did not comply with the reporting framework and were not reviewed before submission, as the internal audit and audit committee were not functioning effectively during the year under review. Moreover; requests for information were not honoured as agreed upon and key officials were not available to acknowledge requests and address the audit findings during the audit. Furthermore, the organisational structure did not address areas of responsibility to support effective controls over performance information reporting.

### **Investigations**

40. The municipal manager was suspended pending investigations instituted by the municipal council.

## **REPORT ON OTHER LEGAL AND REGULATORY REQUIREMENTS**

### **Report on performance information**

41. I was engaged to review the performance information.

### **The accounting officer's responsibility for the performance information**

42. In terms of section 121(3)(c) of the MFMA, the annual report of a municipality must include the annual performance report of the municipality, prepared by the municipality in terms of section 46 of the Local Government: Municipal Systems Act, 2000 (Act No. 32 of 2000) (MSA).

### **The Auditor-General's responsibility**

43. I conducted my engagement in accordance with section 13 of the PAA read with *General Notice 616 of 2008*, issued in *Government Gazette No. 31057 of 15 May 2008* and section 45 of the MSA.

44. In terms of the foregoing my engagement included performing procedures of a review nature to obtain sufficient appropriate evidence about the performance information and related systems, processes and procedures. The procedures selected depend on the auditor's judgement.

45. I believe that the evidence I have obtained is sufficient and appropriate to provide a basis for the findings reported below.



## **Findings on performance information**

### **Non-compliance with regulatory requirements**

#### **No reporting of performance information**

46. The Indaka municipality has not reported performance against predetermined objectives, as required by section 46 of the MSA and section 121(3)(c) of the MFMA.

#### **Internal auditing of performance measurements**

47. The Indaka municipality did not develop and implement mechanisms, systems and processes for auditing the results of performance measurements as part of its internal audit processes, as required in terms of section 45 of the MSA.

#### **Lack of adoption or implementation of a performance management system**

48. The Indaka municipality did not adopt a framework that describes and represents how the municipality's cycle and processes of performance planning, monitoring, measurement, review, reporting and improvement will be conducted, organised and managed, including determining the roles of the different role players, as required in terms of regulations 7 and 8 of the Municipal Planning and Performance Management Regulations, 2001.

#### **No mid-year budget and performance assessments**

49. The accounting officer of the Indaka municipality did not (by 25 January of each year) assess the performance of the municipality during the first half of the financial year, taking into account the municipality's service delivery performance during the first half of the financial year and the service delivery targets and performance indicators set in the service delivery and budget implementation plan, as required by section 72 of the MFMA.

## **APPRECIATION**

50. The assistance rendered by the staff of the Indaka municipality during the audit is sincerely appreciated.

Pietermaritzburg

15 January 2010



AUDITOR - GENERAL  
SOUTH AFRICA

*Auditing to build public confidence*

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**REPORT ON THE FINANCIAL STATEMENTS**

**Introduction**

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**The accounting officer's responsibility for the financial statements**

2. The accounting officer is responsible for the preparation and presentation of these financial statements in accordance with the entity-specific basis of accounting, as set out in accounting policy note 1 and in the manner required by the Local Government: Municipal Finance Management Act, 2003 (Act No. 56 of 2003) (MFMA) and for such internal control as the accounting officer determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

**The Auditor-General's responsibility**

3. As required by section 188 of the Constitution of the Republic of South Africa, 1996 read with section 4 of the Public Audit Act, 2004 (Act No. 25 of 2004) (PAA) and section 126(3) of the MFMA, my responsibility is to express an opinion on the financial statements based on conducting the audit in accordance with the International Standards on Auditing and *General Notice 616 of 2008*, issued in *Government Gazette No. 31057 of 15 May 2008*. Because of the matters described in the Basis for disclaimer of opinion paragraphs, however, I was not able to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion.

**Basis for disclaimer of opinion**

**Operating expenditure**

4. The completeness, occurrence and accuracy of general expenses totalling R5,7 million in the analysis of operating income and expenses could not be confirmed due to limitations placed on the scope of audit work. In this regard, supporting documentation and related explanations were not provided by the municipality due to the absence of key financial personnel throughout the audit.
5. Payments amounting to R278 125 were not made in accordance with the lease agreements. In this regard, supporting documentation and related explanations were not provided for the unexplained overpayment by the municipality. Consequently, I could not obtain sufficient appropriate audit evidence as to the completeness, occurrence and accuracy of this expenditure due to limitations placed on the scope of audit work.

### **Management Response**

Noted, all lease agreements that the municipality has to be investigated as well as repayments amounts, and any over or under payments to be adjusted accordingly

### **Provisions**

6. The valuation, existence, completeness and obligations of the leave pay provision totalling R660, 228 as disclosed in note 8 to the financial statements could not be confirmed due to the limitations placed on the scope of the audit work. Furthermore, alternative procedures were not feasible because leave registers were not up to date and records supporting the balances could not be provided.

### **Management Response**

The municipality is currently doing an audit, and a dedicated HR person has been appointed.

### **Unauthorised expenditure**

7. The municipality has omitted disclosure of unauthorised expenditure amounting to R360 874 incurred during the financial year on the purchase of capital assets. This is contrary to section 125(d)(i) of the MFMA which requires disclosure of unauthorised expenditure in the financial statements.

### **Management Response**

Noted, the above expenditure to be investigated and reported to the council, should the expenditure be found to be unauthorised it will be reported to the relevant stakeholders

### **Value-added Taxation (VAT) payables**

8. VAT amounting to R100 068,89 in respect of repairs and maintenance and general expenditure was incorrectly recorded in expenditure accounts. Consequently, the projected overstatement of general expenses and repairs and maintenance amounts to R579 949 and R26 005 respectively whilst VAT payable is understated by the same amounts.

### **Management Response**

The municipality has engaged the services of Maxprof the Vat specialist to recover the outstanding vat refunds as well as advising the municipality on other vat related issues, and there is also transfer of skills in the process.

### **Fixed assets**

The municipality did not implement appropriate asset management policies and procedures and as a result, the following misstatements were noted during the audit:

9. Assets financed from grants amounting to R11,09 million as per the analysis of fixed assets, did not agree to the asset register which reflected R10,66 million. As a result of insufficient supporting documentation and explanations; the accuracy, completeness and occurrence of the additions to fixed assets amounting to R337 394 financed from grants could not be confirmed.

**Management Response**

The municipality will engaged the services of an accounting and auditing firm to do conversion of AFS to GRAP GAMAP which involves inter alia the sorting out of fixed asset register to be GAMAP compliant and converting 2008/2009 financial statements (taking into account the audit report there to) which will be used as opening balances in 2009/2010 AFS

10. Contributions to fixed assets from operating income of R193 429 as per the analysis of operating income and expenditure did not agree to the analysis of fixed assets. Consequently fixed assets are overstated by R193 429 and accumulated deficit is understated by the same amount.

**Management Response**

The municipality will engaged the services of an accounting and auditing firm to do conversion of AFS to GRAP GAMAP which involves inter alia the sorting out of fixed asset register to be GAMAP compliant and converting 2008/2009 financial statements (taking into account the audit report there to) which will be used as opening balances in 2009/2010 AFS

11. External loans redeemed or written off during the period amounting to R562 443 was not included in the analysis of fixed assets and the analysis of operating income and expenditure. Consequently fixed assets are overstated by R562 443 and accumulated deficit understated by the same amount.

**Management Response**

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12. Umgejakazi access road which was completed during the period under review per the projects progress report was not capitalised. As a result fixed assets are understated by R648 945.00 and accumulated deficit overstated by the same amount.

**Management Response**

**Noted, the financial statements to be corrected, as part of Gamap conversion**

Due to the matters described in paragraph 9 to paragraph 12 above, fixed assets are materially misstated and inappropriately disclosed in the financial statements.

13. Fixed assets to the value of R99 055.87 could not be physically located. The fixed asset register is projected to include assets amounting to R326 226 that do not physically exist. The municipality's records did not permit the application of alternative audit procedures. Consequently, I was unable to obtain sufficient appropriate audit evidence to confirm the existence of the assets.

**Management Response**

**The said assets had been located and will form part of the gamap compliant asset register.**

14. With reference to accounting policy 3.1, the municipality's accounting policy is to recognise fixed assets at historic cost or at valuation (based on the market price at date of acquisition), where assets have been acquired by grant or donation while they are in existence and fit for use. However, all fixed assets acquired before 01 July 2007 were stated at revalued amounts. This is the result of a decision taken by management at the start of the preceding financial year and that caused me to qualify my audit opinion on the financial statements relating to that year. Consequently, fixed assets and loans redeemed and other capital receipts were understated by an amount of not less than R691 020.

**Management Response**

The municipality will engaged the services of an accounting and auditing firm to do conversion of AFS to GRAP GAMAP which involves inter alia the sorting out of fixed asset register to be GAMAP compliant and converting 2008/2009 financial statements (taking into account the audit report there to) which will be used as opening balances in 2009/2010 AFS

**Accruals**

15. Expenditure amounting to R650 000 incurred on the preparation and staging of the memorial and funeral service of the mayor was unaccounted for. As a result accruals and expenditure are understated by R650 000. Moreover, insufficient explanations and documentation were provided in support of the expenses. Consequently I was unable to satisfy myself that the expense was incurred in accordance with the scope of the municipal operations.

**Management Response**

The municipality will engaged the services of an accounting and auditing firm to do conversion of AFS to GRAP GAMAP which involves inter alia the sorting out of fixed asset register to be GAMAP compliant and converting 2008/2009 financial statements (taking into account the audit report there to) which will be used as opening balances in 2009/2010 AFS

16. The short term portion of the DBSA loans were incorrectly classified as long term liabilities. Instalments amounting to R225 000 should have been made for the current year. Consequently long term liabilities are overstated and current liabilities are understated by R225 000.

**Management Response**

Noted, financial statements to be corrected

**Accumulated Deficit**

17. A difference of R320 798 (2007/08 - R188 112) was noted for accumulated deficit. The accumulated deficit as disclosed in the income statement amounted to R5,06 million (2007/08 – R 8,54 million) when compared to the balance sheet and note 13 amount of R5,38 million.(2007/08 – R8,36million). No explanations and documentation in support thereof could be produced on request.

**Management Response**

Noted, financial statements to be corrected

18. There were no disclosure notes and no explanations provided for an amount of R381 680 included in appropriations for the period.

**Management Response**

Noted, financial statements to be corrected

19. Operating surplus for the period as per the income statement amounted to R3,1 million as compared to R2,9 million operating surplus disclosed in note 13. There were no explanations provided for the resultant difference. The municipality's records did not permit the application of alternative audit procedures.

**Management Response**

Noted, financial statements to be corrected

Due to the matters described in paragraph 17 to paragraph 19 above, I was unable to confirm the valuation, existence, and completeness of accumulated deficit as disclosed in the balance sheet and note 13 to the financial statements due to limitations placed on the scope of audit work.

**Reserves**

20. The contributions to reserves and operational expenditure thereon during the period as recorded in the general ledger did not agree to disclosures per Appendix A of the financial statement. Consequently contributions to reserves and operational expenditure thereon are understated by R5, 99 million due to classification errors.

**Management Response**

21. A difference of R230 778 was noted for reserves as disclosed in Appendix A of the financial statements when compared to the closing balances as per the trial balance. No explanations and/or documentation in support of this difference could be produced on request.

**Management Response**

Noted, financial statements to be corrected

## **Cash**

22. The balance sheet reflects a negative bank overdraft of R2,8 million under current liabilities. The municipality had a favorable bank balance at year end and this should be reflected as a current asset. Consequently current assets and current liabilities are understated by R2,8 million.

### **Management Response**

Noted, financial statements to be corrected

## **Capital commitments**

23. The municipality did not have a system in place to account for commitments. Consequently, I was unable to confirm the completeness of commitments as disclosed in note 21 to the financial statements. Moreover, the entity's records did not permit the application of alternative audit procedures.

### **Management Response**

## **Salaries, wages and allowances**

24. Note 10 of the financial statements do not disclose the breakdown of councillor's allowances and senior official remuneration for the current year. As a result the disclosure is not in accordance with accounting policy note 1 and furthermore, is not comparable to the prior year.

### **Management Response**

Noted, financial statements to be corrected, a note to be included

## **Disclaimer of opinion**

25. Because of the significance of the matters described in the Basis for disclaimer of opinion paragraphs, I have not been able to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion. Accordingly, I do not express an opinion on these financial statements.

## **Emphasis of matters**

I draw attention to the following matters on which I do not express a disclaimer of opinion:

## **Basis of accounting**

26. The municipality's policy is to prepare financial statements on the entity-specific basis of accounting, as set out in accounting policy note 1.

### **Going concern**

27. Note 13 to the financial statements indicates that the Indaka municipality has an accumulated deficit of R5,4 million during the year ended 30 June 2009. Conditional grants amounting to R1,2 million had been utilised for operational expenditure. These conditions, along with other matters as set forth in note 24, indicate the existence of a material uncertainty that may cast significant doubt on the entity's ability to continue as a going concern.

#### **Management Response**

The municipality has put aside R3 500 000, 00 in 2009/2010 financial year to reduce accumulated deficit

### **Other matters**

I draw attention to the following matters that relate to my responsibilities in the audit of the financial statements:

#### **Material inconsistencies in other information included in the financial statements**

28. Amounts and disclosures included in paragraph 3.1, 5 and 9 of the treasurers report relating to Grants and subsidies, capital expenditure, and going concern relates to the information disclosed in the prior year and not the current year information. As a result, these disclosures are inconsistent with the current year financial statements.

#### **Management Response**

Noted, financial statements to be corrected

29. Paragraph 8 of the treasurers report incorrectly indicates that the provisions for the prior year amounted to R2,4 million. This is inconsistent with provisions of R660 327 disclosed in note 8 to the financial statements.

#### **Management Response**

Noted, financial statements to be corrected

#### **Material inconsistencies in information included in the annual report**

30. I have not obtained the other information included in the annual report and have not been able to identify any material inconsistencies with the financial statements.

#### **Management Response**

### **Unaudited supplementary schedules**

31. The supplementary information set out on pages xx to xx does not form part of the financial statements and is presented as additional information. I have not audited these schedules and accordingly I do not express an opinion thereon.



## **Non-compliance with applicable legislation**

### **Municipal Finance Management Act**

32. Sections 74(1) and 104(1)(b) of the MFMA were not complied with, in that reports for all contracts awarded over R100,000 had not been submitted to treasury.

#### **Management Response**

The municipality has started reporting to the national treasury for awards R100 000,00 for 2009/2010 fin year.

33. Unauthorised expenditure amounting to R4,6 million as disclosed in the 2007/08 financial statements was not reported to the MEC for Local Government, as required by section 32(4) of the MFMA.

#### **Management Response**

The said expenditure to be reported to MEC for local government as required by the MFMA

34. The accounting officer did not make public the prior year annual report and invite the local community to make representations as required by section 127(5) of the MFMA.

#### **Management Response**

### **Governance framework**

35. The governance principles that impact the auditor's opinion on the financial statements are related to the responsibilities and practices exercised by the accounting officer and executive management and are reflected in the internal control deficiencies and key governance responsibilities addressed below:

### **Internal control deficiencies**

36. Section 62(1)(c)(i) of the MFMA states that the accounting officer must ensure that the municipality has and maintains effective, efficient and transparent systems of financial and risk management and internal control. The table below depicts the root causes that gave rise to the deficiencies in the system of internal control, which led to the disclaimer of opinion. The root causes are categorised according to the five components of an effective system of internal control. (The number listed per component can be followed with the legend below the table.) In some instances deficiencies exist in more than one internal control component.

Par. no.	Basis for disclaimer of opinion	CE	RA	CA	IC	M
4-5	Operating expenditure	5,6	1			
6	Provisions	6		4		
7	Unauthorised expenditure					2
8	Value added tax			5		
9-14	Fixed assets	5	1			3

15-16	Accruals	5	5			
17-19	Accumulated deficit	5	3			3
20-21	Reserves	5				3
22	Cash	5	1			
23	Capital commitments	5				2
24	Salaries, wages and allowances	5				2

37. The municipality did not submit requested information and documentation in support of its financial affairs for the year under review. Governance policies and practices do not operate effectively and are in some instances inappropriate. Moreover, there was a lack of effective, efficient and transparent systems of financial and risk management and internal control during the period under review.

<b>Legend</b>	
<b>CE = Control environment</b>	
The organisational structure does not address areas of responsibility and lines of reporting to support effective control over financial reporting.	1
Management and staff are not assigned appropriate levels of authority and responsibility to facilitate control over financial reporting.	2
Human resource policies do not facilitate effective recruitment and training, disciplining and supervision of personnel.	3
Integrity and ethical values have not been developed and are not understood to set the standard for financial reporting.	4
The accounting officer/accounting authority does not exercise oversight responsibility over financial reporting and internal control.	5
Management's philosophy and operating style do not promote effective control over financial reporting.	6
The entity does not have individuals competent in financial reporting and related matters.	7
<b>RA = Risk assessment</b>	
Management has not specified financial reporting objectives to enable the identification of risks to reliable financial reporting.	1
The entity does not identify risks to the achievement of financial reporting objectives.	2
The entity does not analyse the likelihood and impact of the risks identified.	3
The entity does not determine a risk strategy/action plan to manage identified risks.	4
The potential for material misstatement due to fraud is not considered.	5
<b>CA = Control activities</b>	
There is inadequate segregation of duties to prevent fraudulent data and asset misappropriation.	1
General information technology controls have not been designed to maintain the integrity of the information system and the security of the data.	2
Manual or automated controls are not designed to ensure that the transactions have occurred, are authorised, and are completely and accurately processed.	3
Actions are not taken to address risks to the achievement of financial reporting objectives.	4
Control activities are not selected and developed to mitigate risks over financial reporting.	5
Policies and procedures related to financial reporting are not established and communicated.	6
Realistic targets are not set for financial performance measures, which are in turn not linked to an effective reward system.	7
<b>IC = Information and communication</b>	
Pertinent information is not identified and captured in a form and time frame to support financial reporting.	1
Information required to implement internal control is not available to personnel to enable internal control responsibilities.	2

Communications do not enable and support the understanding and execution of internal control processes and responsibilities by personnel.	3
<b>M = Monitoring</b>	
Ongoing monitoring and supervision are not undertaken to enable an assessment of the effectiveness of internal control over financial reporting.	1
Neither reviews by internal audit or the audit committee nor self -assessments are evident.	2
Internal control deficiencies are not identified and communicated in a timely manner to allow for corrective action to be taken.	3

## Key governance responsibilities

38. The MFMA tasks the accounting officer with a number of responsibilities concerning financial and risk management and internal control. Fundamental to achieving this is the implementation of key governance responsibilities, which I have assessed as follows:

No.	Matter	Y	N
<b>Clear trail of supporting documentation that is easily available and provided in a timely manner</b>			
1.	No significant difficulties were experienced during the audit concerning delays or the availability of requested information.		<input type="checkbox"/>
<b>Quality of financial statements and related management information</b>			
2.	The financial statements were not subject to any material amendments resulting from the audit.		<input type="checkbox"/>
3.	The annual report was submitted for consideration prior to the tabling of the auditor's report.		<input type="checkbox"/>
<b>Timeliness of financial statements and management information</b>			
4.	The annual financial statements were submitted for auditing as per the legislated deadlines section 126 of the MFMA.		<input type="checkbox"/>
<b>Availability of key officials during audit</b>			
5.	Key officials were available throughout the audit process.		<input type="checkbox"/>
<b>Development and compliance with risk management, effective internal control and governance practices</b>			
6.	Audit committee	<input type="checkbox"/>	
	<ul style="list-style-type: none"> <li>The municipality had an audit committee in operation throughout the financial year.</li> </ul>	<input type="checkbox"/>	
	<ul style="list-style-type: none"> <li>The audit committee operates in accordance with approved, written terms of reference.</li> </ul>	<input type="checkbox"/>	
	<ul style="list-style-type: none"> <li>The audit committee substantially fulfilled its responsibilities for the year, as set out in section 166(2) of the MFMA.</li> </ul>		<input type="checkbox"/>
7.	Internal audit		
	<ul style="list-style-type: none"> <li>The municipality had an internal audit function in operation throughout the financial year.</li> </ul>	<input type="checkbox"/>	
	<ul style="list-style-type: none"> <li>The internal audit function operates in terms of an approved internal audit plan.</li> </ul>	<input type="checkbox"/>	
	<ul style="list-style-type: none"> <li>The internal audit function substantially fulfilled its responsibilities for the year, as set out in section 165(2) of the MFMA.</li> </ul>		<input type="checkbox"/>
8.	There are no significant deficiencies in the design and implementation of		<input type="checkbox"/>

No.	Matter	Y	N
	internal control in respect of financial and risk management.		
9.	There are no significant deficiencies in the design and implementation of internal control in respect of compliance with applicable laws and regulations.		<input type="checkbox"/>
10.	The information systems were appropriate to facilitate the preparation of the financial statements.		<input type="checkbox"/>
11.	A risk assessment was conducted on a regular basis and a risk management strategy, which includes a fraud prevention plan, is documented and used as set out in section 62(1)(c)(i) of the MFMA.	<input type="checkbox"/>	
12.	Delegations of responsibility are in place, as set out in section 79 of the MFMA.	<input type="checkbox"/>	
<b>Follow-up of audit findings</b>			
13.	The prior year audit findings have been substantially addressed.		<input type="checkbox"/>
14.	SCOPA/Oversight resolutions have been substantially implemented.	<input type="checkbox"/>	
<b>Issues relating to the reporting of performance information</b>			
15.	The information systems were appropriate to facilitate the preparation of a performance report that is accurate and complete.		<input type="checkbox"/>
16.	Adequate control processes and procedures are designed and implemented to ensure the accuracy and completeness of reported performance information.		<input type="checkbox"/>
17.	A strategic plan was prepared and approved for the financial year under review for purposes of monitoring the performance in relation to the budget and delivery by the Indaka municipality against its mandate, predetermined objectives, outputs, indicators and targets section 68 of the MFMA.	<input type="checkbox"/>	
18.	There is a functioning performance management system and performance bonuses are only paid after proper assessment and approval by those charged with governance.	<input type="checkbox"/>	

39. The financial statements submitted for audit did not comply with the reporting framework and were not reviewed before submission, as the internal audit and audit committee were not functioning effectively during the year under review. Moreover; requests for information were not honoured as agreed upon and key officials were not available to acknowledge requests and address the audit findings during the audit. Furthermore, the organisational structure did not address areas of responsibility to support effective controls over performance information reporting.

## Investigations

40. The municipal manager was suspended pending investigations instituted by the municipal council.

## **REPORT ON OTHER LEGAL AND REGULATORY REQUIREMENTS**

### **Report on performance information**

41. I was engaged to review the performance information.

### **The accounting officer's responsibility for the performance information**

42. In terms of section 121(3)(c) of the MFMA, the annual report of a municipality must include the annual performance report of the municipality, prepared by the municipality in terms of section 46 of the Local Government: Municipal Systems Act, 2000 (Act No. 32 of 2000) (MSA).

### **The Auditor-General's responsibility**

43. I conducted my engagement in accordance with section 13 of the PAA read with *General Notice 616 of 2008*, issued in *Government Gazette No. 31057 of 15 May 2008* and section 45 of the MSA.

44. In terms of the foregoing my engagement included performing procedures of a review nature to obtain sufficient appropriate evidence about the performance information and related systems, processes and procedures. The procedures selected depend on the auditor's judgement.

45. I believe that the evidence I have obtained is sufficient and appropriate to provide a basis for the findings reported below.

### **Findings on performance information**

### **Non-compliance with regulatory requirements**

### **No reporting of performance information**

46. The Indaka municipality has not reported performance against predetermined objectives, as required by section 46 of the MSA and section 121(3)(c) of the MFMA.

### **Internal auditing of performance measurements**

47. The Indaka municipality did not develop and implement mechanisms, systems and processes for auditing the results of performance measurements as part of its internal audit processes, as required in terms of section 45 of the MSA.

### **Lack of adoption or implementation of a performance management system**

48. The Indaka municipality did not adopt a framework that describes and represents how the municipality's cycle and processes of performance planning, monitoring, measurement, review, reporting and improvement will be conducted, organised and managed, including determining the roles of the different role players, as required in terms of regulations 7 and 8 of the Municipal Planning and Performance Management Regulations, 2001.

### **No mid-year budget and performance assessments**

49. The accounting officer of the Indaka municipality did not (by 25 January of each year) assess the performance of the municipality during the first half of the financial year, taking into account the municipality's service delivery performance during the first half of the financial year and the service delivery targets and performance indicators set in the service delivery and budget implementation plan, as required by section 72 of the MFMA.

### **APPRECIATION**

50. The assistance rendered by the staff of the Indaka municipality during the audit is sincerely appreciated.

Pietermaritzburg

15 January 2010



**AUDITOR - GENERAL**  
**SOUTH AFRICA**

*Auditing to build public confidence*